

Chapter 1

INTRODUCTION

1.1. Overview

Malaysia's attempt to restructure the society through the "New Economic Policy" or NEP, 1970 – 1990, denotes a very important shift in Malaysia's economy. NEP is said to have reduced the issues of inequality in income distribution among the major races in Malaysia, namely Malay, Chinese, and Indian. Also, NEP curtailed the identification of these races according to economic functions and geographical locations (Lucas and Verry, 1996). Before the implementation of NEP, Malays were known as farmers and fishermen who live at rural areas, Chinese were the tin miners or the wealthy businessmen who live in town, while the Indians were the rubber-tappers who stay at the rubber estates.

For twenty years, the government had implemented various restructuring actions in narrowing down these economic gaps among the races. The 'bumiputera'² or the native of Malaysia was the priority. This could be due to the fact that they are the origins, yet they fell into the community group whose income grew least rapidly. One of the requirements outlined in NEP is that 30% of the corporate equity of any firm that goes public must contain bumiputera ownership.

Hence, "in the late 1970s, many influential Malays were issued new shares at par value as companies scrambled to fulfill the requirement," (Todd, 1987). As a result, from 1970 – 1989 the bumiputera community had enjoyed the fastest income growth. NEP era is considered as the turning point for the bumiputera or specifically the Malays to walk out from the rural areas and take more active role in exploiting the economic wealth of their very own country. NEP has led them to participate and become more aggressive in the corporate world. A report

² 'Bumiputera' is primarily referred to Malays as they represent the largest native community in Malaysia. Thus, 'Malays' and 'Bumiputera' will be used interchangeably throughout the paper.

indicates from 1971 to 1990, the bumiputera ownership of share capital in Malaysian limited companies rose from 4.3% to 20.3% (Lucas and Verry, 1996).

Despite of the government's help to the bumiputera community, non-bumiputera² ownership of the Malaysian share capital also grew. Their total ownership grew from 34% in 1971 to 55% in 1990 (Lucas and Verry, 1996). It should be noted that as for the non-bumiputera communities, the Chinese community is the dominant group in the Malaysian corporate world. Undoubtedly, the Chinese are the community with the highest income growth.

The fact that they were not the natives had inspired their ancestors to work hard, especially in business activities, in order to improve their status in the country. The community has been living with this strong spirit of survival since then. Hence, their enthusiasm and skills in entrepreneurial are rather inherited and undeniable. Gomez (1999) suggested the increase in non-bumiputera or mainly the Chinese share capital ownership was due to the fact that they are productive. The entrepreneurial deployment of economic benefits secured from the states and effective use of stock market to secure funds to finance their business expansion are also the contributing factors. Another important reason could be the cultivation of patrons from the political leadership. In consequence to the NEP requirement of 30% bumiputera ownership in public listed companies, "the Chinese and the foreign companies began to actively solicit business ties with politically influential Malays who willingly to lend their names for a price without taking on executive roles after becoming owners and directors of the companies," (Gomez 1999).

Apparently, share capital ownership in publicly listed companies could be the indicator to measure the performance and involvement of bumiputera in the corporate business arena. Consequently, ownership structure brings about to the matters of controlling, owning, and firms' performance. According to

² 'Non-bumiputera' is mainly referred to Chinese and Indians communities.

Malaysian Code on Take-Over and Mergers, control is set at 33.3%. However, in the case of highly dispersed structure of ownership, 15% to 20% could also be considered as the controlling shareholders.

Studies to explain how controlling shareholders and ownership structure affect firms' performance have been started for at least sixty-seven years ago. Among the pioneer works on ownership structure and firms' performance was the study by Berle and Means (1932). Although various studies have been conducted, technically, most of the studies, inclusive of the studies done on Malaysian companies, showed less significant relationship. This could be due to the separation of ownership between equity holders and the management of the company that brings in the agency problem. Agency problem exists when management tends to act according to their best interest instead of fully taking care of the equity holders' goal, which is to maximize the firm's profit (Jensen and Meckling, 1976).

1.2. Significance and Objectives of the Study

The excessive encouragement by the government to the bumiputera during NEP has caused to the high dependency of bumiputera controlled companies to the government. Now, as the NEP era is over and NDP (National Development Policy) era is taking over, these bumiputera controlled companies are expected to be more independent and competitive. "The most fundamental shift in NDP is the recognition that many of NEP's goals have been largely attained and the widespread poverty which once afflicted Malaysia's Bumiputera majority is no longer an overwhelming problem. NDP takes into account the needs of all Malaysians," (Tsuruoka and Vatikiotis, 1991).

The purpose of this paper therefore, is to analyze the performance of the bumiputera controlled companies in relation to the ownership structure after the NEP era. Ownership structure will be viewed from the aspects of ethnic ownership and concentration of ownership. Specifically, the objectives are:

1. To observe the performance of bumiputera controlled companies in comparison with the non-bumiputera controlled companies after the NEP era. Bumiputera and non-bumiputera controlled companies are differentiated according to fraction of equity ownership that each ethnic has in the companies³. Thus, the main goal is to see whether *ethnic ownership* could influence the performance of companies.
2. To conduct a comparative analysis in order to see whether *concentration ownership* could give a more significant result on the performance of bumiputera companies and non-bumiputera companies.

1.3. Research Questions

1. Are the bumiputera controlled companies able to continuously improve their involvement in the business world after the NEP era as they are now have to be more independent?
2. Comparing the profit performance of bumiputera and non-bumiputera controlled companies during the economic booming period, are they equally competitive?
3. Is ownership structure representing one of the factors that leads to the differences in profit performance of each group, bumiputera and non-bumiputera companies?

³ Companies with bumiputera ownership at least 50.1% is considered as 'bumiputera controlled companies'. Similarly, companies with non-bumiputera ownership at least 50.1% is regarded as 'non-bumiputera controlled companies.'

1.4. Scope of the Study

The study is based on the companies listed on the KLSE (Kuala Lumpur Stock Exchange) over the period 1993 to the first quarter of 1997. Such duration is chosen as to see the performance of bumiputera companies few years after the NEP era. By the year 1993, the companies were expected to be able to establish themselves independently. The performance as of 1997 is regarded as the most recent performance, since data are only available up to that year. The period is also more comparable as those years are the period of Malaysia's economic booming. The study will include only 40 bumiputera and 40 non-bumiputera companies, regardless of the industry, as the basis of comparison. These companies have consistently belonged to their categories throughout the period.

1.5. Limitations of the Study

The study is constrained to the period of 1993 up to the first quarter of 1997. The period is chosen as it represents the period of Malaysia's economic booming. In July 1997 Malaysia experienced a sudden economic downturn. It is believed the study would be more comparable if period of study is limited to a specific economic cycle. Extreme economic disturbance would result in bias findings. In consequent to the economic downturn, for the period of 1998 to 1999, various restructuring plans have taken place. Thus, the findings of this study might not be fully representing the current performance of public listed companies in Malaysia.

Further, this study only counts for the profit performance of companies. Therefore, in order to control the profit performance, the variables used are mainly accounting variables like sales, long-term debt to equity, and growth in net income. Other possible performance factors like product development, expansion, acquisition, or change in management are not considered, as those elements are rather subjective and less measurable.

Another limitation that should be considered is the restraint in the sampling. The samples are not confined according to industries. This partly because the number of companies in each industry, that manage to satisfy the criteria for the study's sample selection, would be very small. Thus, comparing the performance of companies in a particular industry would involve a very small number of samples to bring about a generalization.

1.6. Organization of the Study

This paper consists of five major chapters. This first chapter mainly talks about the basic introductory to the study, which includes the overview of study, objectives of study, research questions, scope of study, and the limitations.

The following chapter covers the literature review. This includes the recapture of NEP and bumiputera communities as well as NEP and non-bumiputera communities. Also, the chapter discusses the theories on ownership structure and firms' performance. The previous studies on relationship between ownership structure and firms' performance that have been done internationally and locally are also discussed in this chapter.

The next chapter, the chapter on research methodology, clarifies the formulation of hypotheses of the study, the tests and analyses used, the definition employed for the important terms, and the variables involved.

The continuing chapter discusses the results of the study. Results are mainly based on the statistical analysis done and theories discussed. Finally, the last chapter concludes the findings and suggests for some improvement that could be done on this study in the future.